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September 9, 2003

VIA ELECTRONIC FILING

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S. W. – Room TWB-204
Washington, D. C. 20554

Re: *Ex parte,* CC Docket No. 96-149, Verizon Petition for Forbearance from the Prohibition of sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules

Dear Ms. Dortch:

On Monday, September 8, 2003, Aryeh Friedman and the undersigned of AT&T and Dr. Lee Selwyn, President of Economics and Technology, Inc., met with William Dever and Christi Shewman of the Wireline Competition Bureau's Competition Policy Division. The purpose of the meeting was to discuss Dr. Selwyn's arguments about the costs and/or savings Verizon will incur if it is allowed to provide long distance operation, installation and maintenance functions on an integrated basis as well as the potential for anticompetitive misallocation of costs between Verizon's regulated and competitive lines of business without the existing structural separation between Verizon and its long distance affiliate. Each of these topics is covered in detail in previously submitted declarations sponsored on behalf of AT&T by Dr. Selwyn. The attached document provides a summary of the topics discussed and was distributed at the meeting to the Commission staff in attendance.

Consistent with Section 1.1206 of the Commission's rules, I am filing one electronic copy of this notice and request that you place it in the record of the above-captioned proceeding.

Sincerely,

F S Simone

ATTACHMENT

cc: W. Dever
P. Megna
C. Shewman
R. Tanner

Integration of Verizon LEC/affiliate OI&M will result in pervasive and anticompetitive misallocation of costs between Verizon's regulated and competitive lines of business.

- When the same pool of corporate resources is utilized to jointly support regulated monopoly and nonregulated competitive services, Verizon assigns only the short-run incremental costs to the competitive service, such that all or virtually all of the gains from integration inure solely to its competitive lines of business.

- Verizon's Sec. 272(b)(5) disclosures demonstrate that for services that Verizon does not also offer to non-affiliated rivals, it charges its Sec. 272 affiliates only the additional short-run incremental costs that are over and above the costs that would exist anyway to support the monopoly services if the competitive services did not exist.

- In those instances where Verizon does charge its affiliate the same price it charges others, the affiliate frequently ignores these intracorporate transfer payments when setting its own retail prices, creating a price squeeze for its rivals.

- If Verizon's competitive affiliates are permitted to "piggy-back" on the LECs' core business and resources, and since such opportunities are not offered to non-affiliated rivals, then those entities acquire an unfair and potentially insurmountable competitive advantage over non-integrated rivals, enabling Verizon to impose a price squeeze that will ultimately drive rivals out of the market.

- RBOCs have found other creative means for transferring costs from their competitive lines of business to their monopoly LECs. For example, SBC first made Pacific Bell utilize the SBC brand and mark in place of PacBell's own longstanding and highly recognized corporate identity, and then imposed a $400-million per year "license fee" upon Pacific Bell for its "use" of the SBC brand.

Most of the "savings" that Verizon claims will result from OI&M integration appear to result from the transfer of costs from the affiliates to the LECs, rather than from a net *avoidance* of costs overall.

- The magnitude of the "savings" that Verizon claims it will realize if the affiliates' OI&M functions are "absorbed" by the Verizon LECs confirms that Verizon intends to compensate the LECs only for those affiliate OI&M functions that the LEC is not able to "absorb" – i.e., that will entail additional costs, such as the hiring of additional personnel.

- Moreover, Verizon's "absorption" theory presupposes that its LECs currently have excess capacity in the form of idle personnel.

After-the-fact audits and *ex post* regulatory actions cannot correct or reverse the competitive gains that Verizon can achieve through such misallocation and discrimination.

- Verizon and the other RBOCs have been able to make unprecedented gains in market share since receiving Sec. 271 authorization by exploiting their integration opportunities and preemptive access to ILEC customers.

- While Sec. 272(b)(5) requires that the LEC and Sec. 272 affiliate deal with each other "at arm's length," actual conduct confirms that this *statutory requirement* is being systematically flouted. For example, Verizon LEC personnel actively promote Verizon Long Distance on inbound customer-initiated contacts and in so doing assist VLD in cannibalizing the Verizon LECs' intraLATA toll customer base to the economic disadvantage of the LEC. VLD has not compensated the Verizon LECs for the full and fair market value of the information and inbound contacts that the Verizon LECs furnish, gratis, to VLD.

- In the two- to three or more years that intervene between the initiation of unlawful conduct by Verizon and its ultimate detection in an audit and elimination through affirmative regulatory action, Verizon could amass enormous market share gains that rivals injured by its practices would have no practical means for recovering. Put another way, whatever "penalty" or "punishment" might ultimately be imposed upon Verizon for such conduct would represent little more than an inconsequential slap on the wrist, a "cost of doing business" that would have no perceptible impact upon Verizon's conduct.

The "costs" of continued OI&M separation, *if any actually exist at all*, are a small societal price to pay to help assure the development and sustainability of a competitive telecommunications market.

- From the very outset, the FCC recognized that competition might result in the loss of short-run static efficiencies, but determined that the dynamic gains from competition were well worth that "cost" in terms of the potential losses in scale of production:

> Data and other specialized users may require not only a different application of communications technology, but also have service requirements that are heterogeneous in character. ... To the extent that customers may be attracted by any or all of these or

> other features ... it is a reasonable conclusion that the effect of new entry would be expansion of the total communications market. Moreover, competition within the market for specialized services should motivate innovations or modifications in the service offerings and/or facilities by all carriers serving that market and thus produce even greater growth rates in total specialized traffic than the growth rates projected in the context of the existing industry structure.[1]

In fact, the mushrooming of telecom technology, innovation, investment, and demand that have been driven by the interexchange competition spawned by that 1971 ruling confirm the importance of this policy. Now is not the time to backtrack and to afford greater importance to static efficiencies than to dynamic gains.

- Verizon has not provided any credible evidence that OI&M separation creates static losses in efficiency, but even if such "losses" are present, the potential harm to competition from OI&M integration would still not justify that policy concession.

1. *Specialized Common Carrier Services*, 29 FCC 2d 870, 907 (1971).